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No. 89-1105

In the Supreme Court of the United States

OCTOBER TERM, 1989

JOHN C. ZINNIEL, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

KENNETH W. STARR
Solicitor General
SHIRLEY D. PETERSON
Assistant Attorney General
GILBERT S. ROTHENBERG
LINDA E. MOSAKOWSKI
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

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QUESTION PRESENTED

1. Whether a court's decision to award or deny litigation costs under 26 U.S.C. 7430 is reviewable under an abuse of discretion standard.

2. Whether the Tax Court abused its discretion in denying petitioners' motion for litigation costs on the ground that the Commissioner's litigating position was reasonable.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-26a) is reported at 883 F.2d 1350. The Tax Court's memorandum sur order concerning litigation costs (Pet. App. 31a-36a) is unreported. The opinion of the Tax Court (Pet. App. 38a-56a) on the underlying merits is reported at 89 T.C. 357.

JURISDICTION

The judgment of the court of appeals (Pet. App. 27a-28a) was entered on September 6, 1989. A petition for rehearing was denied on October 18, 1989 (Pet. App. 29a-30a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. For many years, small corporations meeting specified criteria have had the option of electing to be taxed under the special provisions of Subchapter S of the Internal Revenue Code (26 U.S.C.). Prior to 1976, Section 1372(e)(1) of the Code required new shareholders to consent affirmatively to a corporation's Subchapter S election within the time prescribed by regulation. If no action was taken by those shareholders, the corporation's Subchapter S status would be terminated. This statutory scheme resulted in the inadvertent termination of Subchapter S elections in many cases, because new shareholders sometimes failed to file a statement of affirmative consent. To alleviate this problem, Congress in 1976 amended the statute to provide that a new shareholder, within 60 days of becoming a shareholder, would affirmatively have to refuse to consent to the Subchapter S election if he desired to terminate the corporation's Subchapter S status. Under the amended statute, therefore, inaction resulted in retention (rather than termination) of the corporation's Subchapter S status. See Pet. App. 3a-4a; Staff of the Joint Comm. on Taxation, *General Explanation of Tax Reform Act of 1976*, 94th Cong., 2d Sess., at 211 (Comm. Print 1976).

The amended statute provided that the Subchapter S election would terminate if the new shareholder "affirmatively refuses (in such manner as the Secretary shall by regulations prescribe) to consent to such election." 26 U.S.C. 1372(e)(1) (1976). The parties stipulated, however, that, at all times relevant to this litigatio.., there were no regulations, letter rulings, or revenue procedures setting forth the manner in which a new shareholder should terminate the Subchapter S election (Pet. App. 7a). Proposed Treasury regulations addressing this requirement were promulgated on April 17, 1980. See *id.* at 52a-54a.

2. Petitioners John Zinniel, David Merryfield, and James Samuels each owned one-third of the outstanding shares of stock in Sierra Limited, a Wisconsin corporation. Sierra had elected Subchapter S status, effective for Sierra's tax year ended March 31, 1977. Pet. App. 3a, 39a-40a. Petitioners were advised by counsel that it would be desirable to terminate Sierra's Subchapter S election so that the corporation would be permitted to adopt a qualified pension plan. Petitioners were further advised that a termination could be effected if new shareholders failed to consent to the election.

Accordingly, on November 30, 1977, each of Sierra's shareholders transferred 30 shares of Sierra stock to his wife. At the same time, the wives executed and filed with Sierra a document entitled "Refusal to Consent to Small Business Corporation Election," which stated that the wives, as new shareholders, did not consent to Sierra's being treated as a Subchapter S corporation (see Pet. App. 41a). This document was not filed with the IRS within the 60-day period set forth in the statute. *Id.* at 5a-6a, 40a. For the years ended March 31, 1978, and March 31, 1979, Sierra reported its taxable income as if it were not a Subchapter S corporation. And on petitioners' personal income tax returns for 1978 and 1979, they reported their income and any earnings from Sierra as if Sierra were not a Subchapter S corporation. *Id.* at 6a-7a, 39a.

3. The IRS subsequently determined that Sierra's Subchapter S election had not been terminated effectively because the IRS had not been notified of the new shareholders' refusal to consent to the election. This determination resulted in the issuance of notices of deficiency to petitioners, because petitioners were therefore required to report distributive shares of Sierra's income, losses, and various credits, as well as certain excess contributions that had been made on behalf of petitioners under Sierra's pen-

sion plan. Pet. App. 7a-8a, 42a. Petitioners sought review of the asserted deficiencies in the Tax Court, maintaining that the filing *with the corporation* of a "Refusal to Consent" form complied with the statutory requirement. See *id.* at 8a, 44a.

The Tax Court held in favor of petitioners (Pet. App. 38a-56a). Examining the text of the statute (*id.* at 45a-46a) and its legislative history (*id.* at 46a-52a), the court concluded that the statute itself did not require new shareholders to file affirmative refusals to consent with the IRS in order to terminate a Subchapter S election. Accordingly, the court held that the new shareholders had effectively terminated Sierra's Subchapter S election by filing the Refusal to Consent with Sierra within the 60-day period.

4. Petitioners thereafter filed a motion for litigation costs under 26 U.S.C. 7430.[1] Rejecting petitioners' contention that the position of the United States in the civil proceeding "was unreasonable because it lacked any legal foundation," the Tax Court denied the motion (Pet. App. 31a-36a). The court explained that the issue of statutory construction in this case had never before been addressed by any court and that it involved "a complex analysis of section 1372(e)(1) and that section's legislative history, as well as the regulations underlying section 1372(e)(1)" (Pet. App. 35a). The Tax Court concluded (*ibid.*): "While we disagreed with [the Commissioner's] reading of those materials, we do not think that his position concerning section 1372(e)(1) was unreasonable."

5. The court of appeals affirmed (Pet. App. 1a-26a). Relying on this Court's decision in *Pierce* v. *Underwood*,

[1] Because this case was commenced prior to December 31, 1985, the litigation costs question is governed by the version of Section 7430 enacted in 1982. This provision was later amended both in 1986 and 1988. See Pet. App. 12a n.8; p. 11 & note 7, *infra*.

108 S. Ct. 2541 (1988), the court first held that the trial court's determination regarding an award of attorneys' fees under Section 7430 is reviewable under an abuse of discretion standard (Pet. App. 9a-11a). The court then determined that the Tax Court did not abuse its discretion in concluding that the Commissioner's litigating position was reasonable (*id.* at 13a-18a).[2] After a detailed review of the Tax Court's decision on the merits, the court of appeals expressed agreement with the Tax Court's conclusion that the dispute in this case concerned a complex issue of first impression (*id.* at 15a-17a). The court concluded that "the Commissioner's position with regard to that legislative change can hardly be termed 'unreasonable'—despite his failure to provide 'unequivocal' evidence of a legislative understanding not plainly evident from the text of the statute" (*id.* at 17a). The court added (*id.* at 18a): "The Commissioner cannot be said to have acted unreasonably in assuming that, just because Congress addressed the question of *what* had to be filed, Congress was also abolishing so important a tool in tax enforcement as notification to the IRS."

Judge Will dissented (Pet. App. 19a-26a). He agreed with the majority that the Tax Court's decision should be

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[2] The court noted that there was a conflict in the circuits on "another potential threshold issue in litigation of this sort"—namely, whether the reasonableness of the government's position under the pre-1986 version of Section 7430 is to be determined solely by examining its litigating position or whether the government's administrative position should also be considered. Pet. App. 12a n.8. But the court concluded that this issue was not presented here because petitioners had not clearly argued that the administrative position of the IRS was unreasonable in any way not reflected in the government's litigating position. Specifically, the court of appeals stated that petitioners had not taken issue with the Tax Court's assumption that the crux of petitioners' argument was that the government's position was unreasonable because it was without any basis in law. *Ibid.*

reviewed only for abuse of discretion (*id.* at 19a), but he concluded that the Tax Court had abused its discretion in determining that the Commissioner's position was reasonable. Judge Will found that the failure of the IRS to issue regulations concerning the amended statute, coupled with the fact that petitioners ultimately made the IRS aware that they had terminated the Subchapter S election, made the IRS's position in the litigation unreasonable. *Id.* at 19a-26a.

ARGUMENT

The court of appeals correctly held that the Tax Court did not abuse its discretion in denying petitioners' motion for litigation costs under Section 7430. This essentially factbound decision does not present any issue on which there exists a live conflict in the courts of appeals, and it is fully consistent with the decisions of this Court. Accordingly, there is no reason for further review.

1. Petitioners contend (Pet. 7-10) that certiorari is warranted to resolve a conflict in the circuits regarding the standard of review to be applied upon appellate review of orders granting or denying awards of litigation costs under Section 7430. Petitioners are correct in noting that the Ninth Circuit held in *Sliwa* v. *Commissioner*, 839 F.2d 602, 605 (1988), that a trial court's decision to deny or award litigation costs under Section 7430 should be subject to de novo review on appeal. But that decision was handed down before this Court's decision in *Pierce* v. *Underwood*, 108 S. Ct. 2541 (1988), which explicitly held that awards of litigation costs should be reviewed under an abuse of discretion standard. While *Underwood* involved a litigation costs award made under the Equal Access to Justice Act (EAJA), 28 U.S.C. 2412, rather than Section 7430, the court below correctly viewed that decision as

"definitive guidance" (Pet. App. 10a) on the question presented here. *Underwood* appears to settle the question of the appellate standard of review for attorneys' fee awards, and the Ninth Circuit's earlier decision in *Sliwa* therefore does not present a conflict in the circuits that warrants the attention of this Court.

Petitioners argue (Pet. 8-9) that *Underwood* should not be applied to awards made under Section 7430, because that provision does not contain the phrase "the court finds," which is contained in EAJA. This Court in *Underwood*, however, did not rely primarily on the text of EAJA (see 108 S. Ct. at 2547), and, in any event, the text of Section 7430, like EAJA, vests considerable discretion in the district court. The statute provides that "the prevailing party *may* be awarded a judgment for reasonable litigation costs" (26 U.S.C. 7430(a) (emphasis added)). And the House Report on Section 7430 notes that "[a]n award of reasonable litigation costs to the prevailing party in a civil tax action is discretionary with the court hearing the case" (H.R. Rep. No. 404, 97th Cong., 1st Sess. 12 (1982)).

The court of appeals correctly stated that "the same considerations that the Supreme Court found controlling in the EAJA situation also should be controlling with respect to section 7430" (Pet. App. 11a). The Court's concern in *Underwood* that "a request for attorney's fees should not result in a second major litigation" (108 S. Ct. at 2549), which could lead to appellate precedent on the merits of an issue not otherwise presented to the court of appeals (see *id.* at 2548), is as applicable in civil tax litigation as it is in other kinds of civil litigation. And because Section 7430, like EAJA, involves a determination of the reasonableness of the "position of the United States," there is equal applicability here of this Court's conclusions in *Underwood* that the abuse of discretion standard permits the needed

flexibility in developing guidelines for evaluating the "position of the United States" (108 S. Ct. at 2548-2549) and that a court's determination of the "position of the United States" is "[n]ot infrequently" influenced by evidence and facts that are not part of the record on appeal (108 S. Ct. at 2547).[3] Thus, the Court's conclusion in *Underwood* that, even when a court's determination is "based upon evaluation of the purely legal issue governing the litigation" (108 S. Ct. at 2547), the abuse of discretion standard of review for an award of litigation costs promotes judicial economy while adequately protecting the appellant's right to meaningful review should be fully applicable to awards under Section 7430. If the Ninth Circuit nonetheless were to determine at some future time that awards under Section 7430 should be subject to a different standard of review than awards under EAJA, there would be a conflict with the decision below that might warrant the attention of this Court; the pre-*Underwood* decision in *Sliwa*, however, does not meaningfully portend that such a conflict will ever arise.[4]

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[3] Moreover, this Court in *Underwood* rejected the contention urged by petitioners here that, when the underlying facts are undisputed, "an appellate court is 'in as good a position as a trial court' to examine the record" (Pet. 10). As the Court explained, even when the appellate court can acquire the trial judge's full knowledge of the factual setting, that knowledge "will often come at unusual expense" because the appellate court will be required to undertake "the unaccustomed task of reviewing the entire record," not just to determine whether that record supports the fact finder on the merits, but also to determine whether "urging of the opposite merits determination was substantially justified" (108 S. Ct. at 2547).

[4] Petitioner also cites (Pet. 7) *United States* v. *Harvis Construction Co.*, 857 F.2d 1360 (9th Cir. 1988), which was decided shortly after *Underwood* was handed down. That decision, however, did not acknowledge or discuss this Court's decision in *Underwood*; indeed, the question of the correct standard of review was not even in issue

2. a. Nor is there merit in petitioners' contention (Pet. 15-18) that, even under an abuse of discretion standard of review, the court of appeals erred in affirming the Tax Court's denial of litigation costs. Both courts below correctly concluded that the question presented on the merits in this case was one of first impression to which there was no clear answer, and therefore that it was not unreasonable for the Commissioner to litigate the meaning of the 1976 amendment to Section 1372(e)(1).

Petitioners do not seriously dispute that there was room for debate about the meaning of Section 1372(e)(1),[5] and that question, in any event, clearly presents no broad issue warranting this Court's review. Instead, petitioners maintain that the Commissioner's position was unreasonable because the Secretary of the Treasury failed timely to promulgate regulations mandated by the statute. But the appropriateness of an award of litigation costs to a particular litigant turns upon whether the "position of the United States *in the civil proceeding* was unreasonable" (26 U.S.C. 7430(c)(2)(A)(i) (1982) (emphasis added)), *i.e.*, the reasonableness of government's position in the litigant's own case. Petitioners cite no authority for the proposition that the government's action or inaction in issuing regulations having application to taxpayers generally is relevant to an award of litigation costs under Section 7430. To the

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there because both parties in that case had agreed that, under *Sliwa*, de novo review was appropriate. Thus, *Harvis* sheds no light on what the Ninth Circuit's post-*Underwood* position on appellate review of fee awards under Section 7430 will be.

[5] Petitioners suggest (Pet. 16-17) that it was unreasonable for the Commissioner to rely upon the Joint Committee on Taxation's, *General Explanation of the Tax Reform Act of 1976, supra*. But irrespective of whether such explanations by the Joint Committee are, strictly speaking, "legislative history," it has repeatedly been recognized that they are relevant guides to congressional intent. See, *e.g.*, *United States* v. *Darusmont*, 449 U.S. 292, 300 (1981); *FPC* v. *Memphis Light, Gas & Water Div.*, 411 U.S. 458, 471-472 (1973).

contrary, in enacting Section 7430 Congress explained that the court's determination is "to be made on the basis of the facts and legal precedents relating to the case as revealed in the record." H.R. Rep. No. 404, *supra*, at 12; Senate Committee on Finance, Technical Explanation of Committee Amendment, 127 Cong. Rec. 32,070, 32,077 (1981). Whether or not the government acted unreasonably in failing to issue regulations under Section 1372(e)(1), the question under Section 7430 was the reasonableness of "the position of the United States" that, even in the absence of such regulations, the statute required new shareholders to notify the IRS of their refusal to consent to Subchapter S status—and therefore that Sierra remained a Subchapter S corporation during the years at issue. There is no basis for disturbing the conclusion of both courts below that this position of the Commissioner was reasonable.[6]

b. Petitioners also argue (Pet. 10-15) that this Court should grant certiorari to resolve a conflict in the circuits over the meaning of the phrase "position of the United States" in the version of Section 7430 applicable here. The courts of appeals are divided on the question whether this phrase refers only to the government's litigating position or also includes the pre-litigation position taken by the IRS in the particular case. See Pet. 10-11; Pet. App. 12a n.8. As the court of appeals found (*ibid.*), however, this issue is not raised by this case. Petitioners did not argue below that there was a material difference for these purposes between the government's administrative and litigating positions; their contention was, and is, that the

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[6] This Court has recognized that the task of preparing regulations under new legislation "may well occasion some delay" and that a taxpayer is not necessarily entitled to have his interpretation of a statute upheld during the period before implementing regulations have been issued. *Helvering* v. *Reynolds*, 313 U.S. 428, 433 (1941).

government was unreasonable in taking the position—both in court and at the administrative level—that Section 1372(e)(1), standing alone without regulations, requires a refusal to consent to Subchapter S status to be filed with the IRS.

Even if this conflict were presented by this case, moreover, it would not warrant certiorari. This Court has recently denied certiorari in two cases alleging the identical conflict concerning the correct interpretation of the pre-1986 version of Section 7430, and there is no more reason to grant certiorari here. See *Saul* v. *United States*, 108 Sup. Ct. 2901 (1988); *Harrison* v. *Commissioner*, 109 Sup. Ct. 1771 (1989). As we explained in our responses in those cases, the version of Section 7430 at issue here applies only to cases commenced on or before December 31, 1985. The Section was amended both in 1986 and again in 1988, and those amendments expressly provide that the "position of the United States" includes specified administrative actions by the IRS.[7] Thus, the conflict asserted by petitioners, even if it were presented here, concerns a statute that is relevant only to a dwindling number of cases

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[7] Section 1551(e) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2753, amended Section 7430(c) to define the term "position of the United States" in Section 7430(c)(4) as follows:

> *Position of United States*—The term "position of the United States" includes—
>
> (A) the position taken by the United States in the civil proceeding, and
>
> (B) any administrative action or inaction by the District Counsel of the Internal Revenue Service (and all subsequent administrative action or inaction) upon which such proceeding is based.

The Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6239, 102 Stat. 3745-3746, amended Section 7430 again to specify different administrative actions of the IRS that are to be

commenced prior to 1986, and there is no need for this Court to resolve it.[8]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

SHIRLEY D. PETERSON
Assistant Attorney General

GILBERT S. ROTHENBERG
LINDA E. MOSAKOWSKI
Attorneys

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covered, effective for proceedings commenced after November 10, 1988. Section 7430(c)(7) of the Internal Revenue Code now provides:

> '*Position of United States*—The term "position of the United States" means—
>
> (A) the position taken by the United States in the judicial proceeding to which subsection (a) applies, and
>
> (B) the position taken in an administrative proceeding to which subsection (a) applies as of the earlier of—
>
> (i) the date of the receipt of the taxpayer of the notice of the decision of the Internal Revenue Service Office of Appeals, or
>
> (ii) the date of the notice of deficiency.

[8] Petitioners argue (Pet. 12-13) that the courts are also in disarray concerning the meaning of the 1986 amendments to Section 7430. But any such disagreement, as well as the ambiguities in the 1988 amendment that petitioners suggest (see Pet. 14), cannot be resolved in this case, which presents the opportunity to construe only the pre-1986 version of Section 7430.

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